Department of Health & Social Care

The National Health Service Pension Schemes (Amendment) Regulations 2024

Report on changes to member contribution rates and the earning thresholds at which rates become payable

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Presented to Parliament pursuant to section 22(2)(b) of the Public Service Pensions Act 2013

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Introduction

This report is laid before Parliament in accordance with section 22(2)(b) of the Public Service Pensions Act 2013 (the ‘2013 act’). It relates to a proposal to make regulations under the 2013 act.

The purpose of the regulations is to further amend the National Health Service Pension Scheme Regulations 2015 (the ‘2015 regulations’) and to update the member contribution structure that will take effect on 1 April 2024.

The proposed regulations provide for implementation of a second phase of changes to member contribution rates and pay thresholds, and a new process for those thresholds to be updated annually. As this proposal includes a change to a protected element of the NHS Pension Scheme (as described in section 22(5)(b) of the 2013 act), we have consulted persons or representatives of those likely to be affected by the change with a view to reaching agreement with them and now lay this report before Parliament.

The purpose of this report is to set out why the Department of Health and Social Care (‘the department’) proposes to make these regulations, having regard to the desirability of not making a change to the protected elements of the scheme under section one of the 2013 act within the protected period.

Background

In 2010, the Independent Public Service Pensions Commission was set up and chaired by Lord Hutton. His report, in 2011, made a number of recommendations on how to reform public service pensions.

The public service pension reforms legislated for under the 2013 act are designed to last for at least 25 years. The provisions in that legislation are intended to ensure a high bar is set for those contemplating changing scheme features. There are enhanced procedural requirements for consultation and a report to Parliament when making changes to ‘protected elements’ for a period of 25 years as the mechanism to support that aim. Member contribution rates under the respective scheme are one of the protected elements.

Section 22 of the 2013 Act sets out the procedure to be followed in the event that the responsible authority (the Secretary of State for Health and Social Care in relation to the NHS Pension Scheme), proposes to make changes that impact on elements of the scheme which are subject to enhanced protection. These elements are protected from modification until 31 March 2040 (the protected period), unless the prescribed procedure set out in section 22 is followed. Where a change is proposed to a protected element during the protected period, the responsible authority must:

- consult those who appear likely to be affected, or representatives of those persons, with a view to reaching agreement
- lay a report before Parliament

Policy objective

The reforms referred to above led to the making of the 2015 regulations. The NHS Pension Scheme requires members to pay contributions as a condition of membership. Regulations 30 and 31 of the 2015 regulations make provision for member contribution rates for each scheme year from 1 April 2015. Pension benefits are costed on the basis that members contribute collectively 9.8% of pensionable earnings across the whole scheme membership. This is known as the member contribution ‘yield’.

While the yield is a fixed percentage, there are a range of approaches that could be taken to ensure that 9.8% is collected from across the whole scheme membership. The simplest method is to ask each member to contribute a flat rate of 9.8%. An alternative is to share out the 9.8% requirement across the workforce by charging a sliding scale of rates to members according to their pensionable earnings. The aggregate amount collected across members adds up to 9.8%. This is the approach taken by the NHS Pension Scheme and is known as ‘tiered contributions’. It has allowed the scheme to reduce potential financial barriers and encourage all NHS staff to participate in the generous pension scheme that is a major component of the NHS reward package and not miss the opportunity to make good quality provision for their retirement. It is intended as a mutual scheme for the whole NHS sector. The NHS workforce encompasses a broad range of professions and occupations with a wide difference in earnings - from porters and healthcare assistants to senior nurses and doctors. Tiering has also allowed the scheme to recognise through higher contribution rates the beneficial effect of income tax relief on contributions and the additional value that higher earners tend to achieve from pension benefits built up under the ‘final salary’ accrual method that is a feature of the older legacy scheme.

Implementing the second phase of member contribution reforms

Further accrual in the final salary legacy schemes closed from 1 April 2022 and all members moved into the 2015 career average scheme for future service. This ended final salary accrual for employed staff and stopped further career average accrual in the legacy schemes for practitioners.

Therefore, the member contribution structure was reviewed in collaboration with stakeholders and following consultation concluding in 2022, changes were made to the member contribution structure and the 2015 regulations.

This resulted in a new contribution structure which featured a reduction in the number of tiers and the steepness of the remaining tiers. This is appropriate in view of the career average accrual method used in the 2015 NHS Pension Scheme under which all staff now build up future pension benefits. It means that high earners would pay lower contribution rates, while continuing to subsidise the rates paid by lower earners. Rebalancing the rates will mean that lower earners will be asked to contribute more than they currently do, but still benefitting from a significant subsidy. The department therefore proposed that adjustments to contribution tiers are done gradually to dampen the impact on take home pay for staff and mitigate the risk of staff leaving the scheme on grounds of affordability.

In response to the 2022 consultation, the department committed to gradually phasing in the new contribution structure over 2 years. The first phase put in place a transitional contribution structure of 11 contribution tiers from 1 October 2022. The proposed amending regulations implement the second phase which moves members to a final 6-tier structure from 1 April 2024.

Improving the process for increasing tier thresholds annually

Since the first phase was implemented in October 2022, the contribution tier thresholds have been increased in line with the Agenda for Change (AfC) pay award for England. This is to reduce the likelihood that salary increases due solely to centrally agreed annual pay awards result in members moving up a contribution tier and see a net reduction in take-home pay. The thresholds for the first tier and entry to the second tier are not increased. This is because the first contribution tier is designed to link to the threshold for basic rate income tax. Scheme members who fall into the first tier will work less than full-time hours but are unlikely to receive tax relief on their contributions unless they have an additional income source. To give these members the benefit of tax relief at source to incentivise pension saving from this group, the contribution rate in the first tier is discounted compared to the rate in the second tier.

The department consulted and then legislated on proposals to increase member contribution thresholds in line with the AfC pay award for England in May 2023, with the changes having backdated effect to 1 April 2023 in line with the implementation of the pay award.

As part of that consultation process the Scheme Advisory Board expressed concerns that there was a need to act quickly to ensure that the implementation of the new member contribution structure aligns with the implementation of the pay award to avoid a position where members temporarily have the value of an award eroded by increased pension contributions.

Under the current process, the department must consult and lay a statutory instrument in the time between the AfC pay award for England being agreed by the NHS Staff Council and the award being paid to staff. In 2023, the pay award was agreed by the NHS Staff Council on 2 May and became payable in June. For staff who are paid weekly, the award became payable in early June. The department therefore had to breach the 21-day rule for laying statutory instruments to avoid a situation where the threshold uplifts are not implemented alongside the pay award resulting in some staff temporarily paying higher contributions. The department takes its responsibilities to Parliament very seriously and has therefore considered ways in which this process for uplifting thresholds in line with the pay award can be streamlined or improved in future years so that the 21-day rule is not breached routinely.

Providing a method on the face of scheme regulations for applying annual increases to contribution thresholds means that process could be completed automatically without the need to lay a statutory instrument. The AfC pay award in England is not always a uniform percentage salary increase for all pay bands. This means the impact on tier thresholds is unknowable in advance and therefore cannot be set in scheme regulations with the degree of precision and predictability that an automatic method requires.

The public service pension schemes for civil servants and teachers apply an automatic annual increase to contribution rate thresholds on 1 April in line with the percentage increase in the Consumer Prices Index (CPI) as measured in the previous September.

The department therefore intends to adopt an automatic CPI indexation approach, to improve the efficiency of the process for uplifting contribution thresholds in future years and provide certainty to members regarding their payable contributions. The proposed amending regulations provide for this methodology to be inserted into scheme regulations. On 1 April the tier thresholds will be increased by the percentage increase in CPI as measured in the previous September. In line with current practice and policy rationale for the first tier, the thresholds for the first tier and entry to the second tier will not be increased.

The department will apply a non-legislative 'better of' test once the AfC (England) pay award for the year is announced. Should the thresholds be higher if increased in line with the pay award, then the department will lay a statutory instrument to apply the marginal increase to thresholds that year. This acts to reduce the likelihood of members permanently drifting into paying a higher contribution rate by virtue of receiving an annual pay award.

The member contribution structure

Table 1 shows the interim 11-tier member contribution structure that has been in place since the first phase of changes were applied from 1 October 2022, with thresholds uplifted as of 1 April 2023 in line with the 2023 to 2024 AfC pay award in England:

Table 1

Tier	Pensionable earnings	Contribution rate from 1 April 2023
1	Up to £13,246	5.1%
2	£13,247 to £17,673	5.7%
3	£17,674 to £24,022	6.1%
4	£24,023 to £25,146	6.8%
5	£25,147 to £29,635	7.7%
6	£29,636 to £30,638	8.8%
7	£30,639 to £45,996	9.8%
8	£45,997 to £51,708	10.0%
9	£51,709 to £58,972	11.6%
10	£58,973 to £75,632	12.5%
11	£75,633 and above	13.5%

Table 2 shows the final 6-tier contribution structure that would come into force from 1 April 2024. The tier thresholds have been increased in line with AfC (England) pay awards for 2022 to 2023 and 2023 to 2024, and then by the rate of CPI as measured in September 2023.

Table 2

Tier	Pensionable earnings	Contribution rate from 1 April 2024
1	Up to £13,259	5.2%
2	£13,260 to £26,831	6.5%
3	£26,832 to £32,691	8.3%
4	£32,692 to £49,078	9.8%
5	£49,079 to £62,924	10.7%
6	£62,925 and above	12.5%

For the purpose of determining a member's contribution tier, their pensionable earnings are rounded down to the nearest whole pound.

Consultation

As referred to above, in accordance with section 22(2)(a) of the 2013 Act, the Secretary of State for Health and Social Care consulted persons or representatives of such persons who appear likely to be affected by the proposed regulations with a view to reaching agreement with them. A list of these consultees is kept up to date on GOV.UK at NHS Pension Scheme: consultee list.

The proposals to reform member contributions and implement a new contribution rate structure in two phases were considered in a previous section 22 report (see Changes to member contributions in the NHS Pension Scheme, 2022). This set out the consultation actions and assessment of the changes having regard to the desirability of not making them during the protected period.

A public consultation was issued on 26 October 2023 and closed on 7 January 2024. In total, 160 responses were received from individuals, trade unions, employers and other organisations. This presented intentions to implement the second phase of member contribution reforms. Further views were not sought on the final 6-tier contribution structure as this had been the subject of previous consultation.

The consultation set out the department's preferred option to uplift tier thresholds automatically by the rate of CPI. The alternative option was to continue with the current approach of increases in line with AfC (England) pay awards. There was a general level of support among respondents for adopting CPI indexation. Of the 160 responses received, 97 (61%) agreed, 33 (20%) disagreed, and 30 (19%) didn't know.

The Scheme Advisory Board ('SAB') is a statutory board comprising trade union and employer representatives, that advises the Secretary of State for Health and Social Care on the merits of making changes to the NHS Pension Scheme. The SAB agreed with the proposal to uplift thresholds by the rate of CPI in the preceding September, noting that although it is not its preferred method for indexation it has practical advantages. They thought that applying a known CPI rate ahead of a new scheme year provides more certainty of contribution changes which would be welcomed by members and allows more time for process changes to be put in place. The SAB considered that uplifting thresholds by CPI or annual AfC (England) increases are both reasonable methods in principle, recognising that neither approach perfectly replicates the salary increase awarded to each member of the scheme.

The SAB expressed acute awareness of instances where increases in gross pay can tip members into paying a higher contribution tier, eroding the value of a pay award or even reducing take-home pay. Other respondents noted the potential impact of such ‘cliff edges’, with several NHS employees expressing concern that moving away from uplifts based on AfC (England) pay awards risks increasing the likelihood of cliff edges again. UNISON indicated their support for linking pension contribution increases to annual NHS pay awards.

The SAB stated that where changes are made to tiers there should be a specific intention to reduce cliff edges and the risk of rises in member contributions undermining pay awards. The Royal College of Midwives expressed their support for this position. The Royal College of Nursing thought that uplifting thresholds in line with CPI is likely to reduce the potential for cliff edge scenarios for members in receipt of annual pay awards. However, they noted that the potential for cliff edges has not been removed entirely. The British Medical Association felt that linking uplifts to CPI is reasonable but considered that there must be mechanisms to address any issues that arise when pay awards exceed inflation and/or pay awards are not implemented in time for the start of a financial year. They suggested that there should be a review mechanism or ability to uplift the thresholds further when pay awards exceed CPI. The SAB suggested that a ‘double lock’ could be applied, where tier thresholds are uplifted by the higher of CPI and the AfC (England) increase. The Pharmacists' Defence Association and an NHS employee working in a managerial capacity both made a similar suggestion, whereby the CPI uplift is applied automatically on 1 April and a later adjustment made once the value of the pay award is known, using the statutory instrument process.

With CPI indexing in mind, the consultation made a supplemental proposal to set the contribution rate structure and approach for the next 4-year valuation period (2024-25 to 2027-28 scheme years). Of the 160 responses received, 92 (58%) agreed, 31 (19%) disagreed, and 37 (23%) didn’t know.

The SAB agreed with the proposal, as did the British Medical Association who commented that having a confirmed structure for the next period would bring greater stability for pension planning purposes. The British Dental Association also agreed and thought that it would be useful for members and employers to have a degree of certainty on the approach taken to contribution rates.

UNISON noted concerns about minimising the divergence between contribution tiers and AfC pay bands. They thought that setting the approach for 4 years would be at the outer limits of acceptability - however, it risks potentially large realignments being required compared to smaller changes every year. The British Medical Association and UNISON argued that if setting the approach for a period then there should be a review mechanism to evaluate how the outcome matches pay increases, with the option to intervene and address issues within the period. The British Dental Association thought that the department and SAB should monitor the yield and distribution of membership across the tiers during the inter-valuation period. They suggested that if it is agreed that the yield is being prejudiced, then there should be the right to make changes before the end of the period.

The Pharmacists' Defence Association Union concluded that they could support this proposal if their suggestion was adopted of applying CPI indexation with a follow up adjustment using the statutory instrument process once the pay award is known. They accepted that in an individual year the drift between CPI and an actual award will be small but were concerned about the longer-term impact.

In response to the consultation, the department noted the general level of support for CPI indexation in principle and recognised the concern raised about minimising ‘cliff edges’ which increasing thresholds in line with AfC (England) pay awards was intended to address. In light of those concerns, the department accepted the proposal by respondents to apply a double-lock style 'better of' approach whereby thresholds are uplifted by the higher of CPI and the AfC (England) award. The department noted the support for setting the contribution rate structure and approach for the next valuation period, and agreed to the suggestion by respondents that the impact be monitored during that period jointly with the SAB with the option of intervening early to take corrective action should that be agreed as necessary.

Impact

The proposed amending regulations mean that many members will see the cost of accruing pension scheme benefits change on 1 April 2024. Approximately 29% of members will see their contribution rates reduced as a result of moving from the current 11-tier interim structure to the new 6-tier structure. However, around 47% of members will see their contribution rates increase and around 24% of members will see their rates remain the same. Of those members that see their rates increase, the majority (92%) will still pay below the yield requirement of 9.8% and effectively receive a discount on membership of the NHS Pension Scheme.

Where the CPI increase as measured at the previous September is greater than the pay award made in the subsequent year, then the 'better of' test that the department commits to applying ensures that the likelihood of drifting into a higher contribution tier due to receiving an annual pay award continues to be minimised for most members. Indexing the contribution tier thresholds annually in line with the increase in CPI could see some members drift down a contribution tier and pay a lower rate if CPI is higher than pay awards. This of course benefits members - however, it requires careful monitoring of the 9.8% contribution yield to ensure that the scheme continues to collect the right level of contribution income across the membership collectively.

Automatically increasing tier thresholds at the start of the scheme year mitigates the timing issue and associated risk of some members experiencing a temporary reduction in take home pay due to the pay award coming into effect before the tier thresholds can be update. This risk will still exist where the pay award exceeds the CPI-linked increase and a marginal increase to thresholds is required - however, the gap will be narrower and therefore the number of staff potentially affected is reduced.

The department has considered these regulations and had regard to the desirability of not making a change to the protected elements of a scheme under section one within the protected period.

If these regulations are not made then the current interim 11-tier member contribution structure would remain in place. The 11-tier structure was never intended to remain in place long-term as it was the first of 2 phases to bring in a larger set of changes to contribution rates. Given that all members have been building up career average benefits from 1 April 2022, the department remains of the view that it is important that the reform of member contributions be completed so that the structure better reflects the nature of career average accrual. The cross-subsidy between high and low earners would remain too great, with high earners paying substantially higher rates than lower earners despite building up benefits at the same proportional rate. However, some cross-subsidy is still appropriate to assist affordability for lower earning members and the new 6-tier contribution structure retains some tiering for that purpose.

The proposed regulations provide for a process to automatically increase relevant contribution tier thresholds at the start of each scheme year (1 April). This is intended to avoid a situation where there is insufficient time for scheme regulations to be updated before members start receiving higher pay following implementation of the AfC pay award for the year. Without this change then depending on how swiftly the pay award is implemented after announcement, there is a risk that either the department will need to breach the 21-day rule again or that some members would temporarily have the value of their pay award eroded by increased pension contributions until amendments to scheme regulations applying the updated tier thresholds can be brought into effect. The department believes that it would be unfair to delay implementation of the pay award while the longer process of updating pension scheme regulations completes.

The consultation and response documents contained information setting out the impact on different types of members, including equality analysis on the proposals. Views were invited from respondents on any further equality considerations and these were taken into account when finalising the policy and associated regulations. The consultation document and response can be found online.

There is no, or no significant, impact on business, charities or the voluntary sector.

Conclusion

Parliament is invited to note the changes to the member contribution structure and rates in the 2015 regulations and why the department proposes to make these regulations, having regard to the desirability of not making a change to the protected elements of the NHS Pension Scheme within the protected period. The National Health Service Pension Schemes (Amendment) Regulations 2024 will be made and laid in Parliament under the negative resolution procedure.

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